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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1979

No. 79-66

PETER E. AARON,

Petitioner,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

BRIEF OF MID-AMERICA LEGAL FOUNDATION AS AMICUS CURIAE

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INTEREST OF AMICUS

This *amicus curiae* brief is submitted on behalf of Mid-America Legal Foundation (*"Mid-America"*) with the consent of both parties being filed with the Clerk of the Court.

Mid-America was organized in 1975 as an Illinois not-for-profit corporation to engage in non-partisan legal research, study and analysis for the benefit of the general public as to evolving concepts of law on our democratic institutions. *Mid-*

America has an interest in this case because the opinion below interprets Section 17(a) of the Securities Act of 1933 (the "1933 Act") and Section 10(b) of the Securities Exchange Act of 1934 (the "1934 Act") in a way which has far reaching ramifications on enforcement actions by the Securities and Exchange Commission (the "Commission") and every other governmental agency.

The Court below effectively imposed a dual legal standard wherein an individual's culpability under the same law is measured solely by the identity of the party bringing the action and not by the statutory language or the challenged conduct. Thus, conduct which is legitimate as to an injured private party may nevertheless support injunctive relief in an action by the Commission under the identical statute.

Despite the extraordinary nature of equitable relief, the decision below granted the Commission an injunction merely upon a showing that the defendant was conscious during a past failure to restrain conduct by others which was later shown to have violated the law. In the absence of evidence that further violations are reasonably expected, however, injunctive relief is clearly inappropriate. The court of appeals ignores the fact that one acting in good faith or without scienter, who is later apprised that certain action or inaction was illegal, is no more likely to continue than any other member of the general public. *See, e.g. SEC* v. *Koracorp Industries,* 575 F.2d 692, 698-699 (9th Cir.), *cert. denied,* 439 U.S. 953 (1978). Yet under these circumstances the court below would impose extraordinary sanctions absent any showing of scienter or bad faith or that the party charged ought to have known that his inaction violated the law.

This dual legal standard results in a quagmire of uncertainty for anyone engaged in investment activity or for that matter anyone subject to government regulation. There simply is no precise norm by which to gauge compliance with the law.

ARGUMENT

1. Scienter must be established by the SEC in an action to enjoin violations of § 17(a)(1) of the 1933 Act and § 10(b) of the 1934 Act.

This Court's decision in *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185 (1976) construed the specific language of § 10(b) of the 1934 Act to include a scienter requirement. Despite that controlling interpretation, the court of appeals found it unnecessary to reach the question whether petitioner's conduct would support a finding of scienter. The lower court concluded that the scienter requirement was inapplicable to government enforcement proceedings to enjoin violations of sections 17(a) of the 1933 Act and 10(b) of the 1934 Act. (Pet. Cert. App. pp. 13a-14a).

The court of appeals attempted to distinguish the present case from *Hochfelder* and the language of § 17(a) from that of § 10(b). In so doing the court ignored important and controlling similarities, and misapplied this Court's holding on the scienter requirement. Although the lower court acknowledged that at least for purposes of § 10(b) the language of the statute at issue here and in *Hochfelder* is the same, it conducted a further unnecessary inquiry into the legislative history of the statute and arrived at a contrary conclusion. In pursuing this inquiry the court of appeals ignored this Court's conclusion in *Hochfelder* that the language of § 10(b) imposes a scienter requirement even though the language of subsection (b) of Rule 10b-5 and, arguably, subsection (c) may not require scienter. The lower court's journey into legislative history for § 10(b) and § 17(a)(1) was simply superfluous. It is a fundamental principle of statutory construction—clear and express wording of the statute is the primary means of determining legislative intent. *See, United States* v. *Oregon,* 366 U.S. 643, 648 (1961); *Packard Motor Car Co.* v. *NLRB,* 330 U.S. 485, 492 (1947).

More specifically, in *Hochfelder* this Court concluded that "the words 'manipulative or deceptive' used in conjunction with 'device or contrivance' strongly suggest that § 10(b) was intended to proscribe knowing or intentional misconduct." 425 U.S. at 197. This conclusion was reinforced further through an admittedly unnecessary review of legislative and regulatory history. 425 U.S. at 201-206.

Hochfelder involved a private claim for damages under § 10(b) and Rule 10b-5. This remedy was not derived from express terms of the statute or the regulation but rather had been implied by lower courts over years of litigation. There is no evidence that either Congress or the Commission contemplated private remedies for violations of these provisions when they were originally enacted. 425 U.S. at 196. Thus, at least initially, the scienter requirement established in *Hochfelder* would have applied only to Commission actions. To conclude that after a private civil remedy has been implied the statute's substantive meaning changed for Commission enforcement proceedings, however, strains the limits of the *Hochfelder* ruling. The identity of the plaintiff provides no basis in fact, in logic or in law for varying the legal standard under the same statutory and regulatory language once that standard has been defined by this Court.

This is not to say that every section of the securities acts employs the same legal standard. *Hochfelder* clearly recognized that private plaintiffs were not required to prove scienter in every action under these Acts. 425 U.S. at 207-208. This Court also carefully noted in *Hochfelder* that the Commission quite likely would not be required to show scienter under subsection (b) of Rule 10b-5, 425 U.S. at 212, which corresponds to § 17(a)(2) or, arguably, under subsection (c) of the Rule which corresponds with § 17(a)(3). *Id.* Indeed the primary teaching of *Hochfelder* is that where the language of the statute clearly imposes a requirement of scienter or intent the agency cannot avoid this standard by regulation—not for

the benefit of injured parties in private suits and not for the benefit of the general public in suits by the Commission. The touchstone is the intent of Congress and not the desirability of the remedy.

The court of appeals, citing its earlier decision in *SEC* v. *Coven*, 581 F.2d 1020, 1026-1027 (2d Cir. 1978), *cert. denied*, ____U.S.____, 99 S.Ct. 1439 (1979) distinguished the wording of § 17(a) from that of § 10(b) and concluded that the former lacked language comparable to that in § 10(b) which this Court found persuasive in *Hochfelder*. (Pet. Cert. App. at 19a).

This conclusion ignores several important aspects of the relationship between § 17(a), § 10(b) and Rule 10b-5. First and most importantly, the language of Rule 10b-5 (a) utilizes the language of § 17(a)(1) and closely parallels the language of § 10(b) which under the *Hochfelder* analysis specifically required scienter. And there the similarity ends. Subsections (2) and (3) of § 17(a) parallel subsections (a) and (b) of Rule 10b-5. Each contains language which, standing alone, might encompass both negligent and intentional behavior, 425 U.S. at 212. However, only § 17(a)(1) is applicable to the facts in the case at bar.

Section 17(a)(2) and (3) could apply in this case only if petitioner conspired in or willfully aided and abetted the conduct proscribed by these provisions. While the record is replete with findings of petitioner's failure to act, it is noticeably lacking in any findings of affirmative action by the petitioner that aided and abetted the misrepresentation.

There simply is no authority to support liability for willfully aiding and abetting without a showing of some culpability on the defendant's part. Inaction alone will not suffice unless the duty to act is clear. *Hochfelder* v. *Midwest Stock Exchange*, 503 F.2d 364, 374 (7th Cir. 1974), *cert. denied*, 419 U.S. 875 (1974).

This Court's discussion in *Hochfelder* of the lack of uniformity in standards of culpability coupled with the many procedural safeguards 425 U.S. at 207-209, reinforces the necessity of evaluating such standards on the basis of statutory construction, not on the identity of the plaintiff bringing the action.

2. A willful violation of the law requires far more than an unwitting or innocent act.

An injunction is an extraordinary form of relief. Its purpose is to cause or prevent specified conduct but its necessity is derived from the very purposefulness of the conduct otherwise likely to occur. *SEC* v. *Bausch & Lomb, Inc.*, 420 F. Supp. 1226, 1245 (S.D. N.Y. 1976), *aff'd on other grounds*, 565 F.2d 8 (2d Cir. 1977). Although an injunction ostensibly operates to restrain not to punish, in practical effect it oftentimes functions as a punitive measure and is so regarded in the investment community.

Thus, the subject enforcement proceeding for prospective injunctive relief to sanction a prior violation of the law wherein the willfulness or intention to violate the law was based on merely voluntary action or inaction without scienter is clearly inappropriate. An individual whose conduct inadvertently aided and abetted the illegal actions of others is no more likely to persist in that conduct once apprised of its unlawfulness, than any other member of the general public.

Moreover, in *United States* v. *Murdock*, 290 U.S. 389 (1933), this Court in rejecting the assertion that willfully "means no more than voluntary," stated:

> "The word [willfully] often denotes an act which is intentional, or knowing, or voluntary, as distinguished from accidental. But when used in a criminal statute it generally means an act done with a bad purpose; without justifiable excuse; stubbornly, obstinately, perversely. The word is also employed to characterize a thing done without ground for believing it is lawful, or conduct marked by careless disregard whether or not one has the right so to act." 290 U.S. at 394-95 (citations omitted).

Thus, a willful violation requires that the actor either knew or ought to have known of the law and the offense. *Spies* v. *United States*, 317 U.S. 492, 497-98 (1943); *Screws* v. *United States*, 325 U.S. 91, 101-103 (1945); and *United States* v. *Bishop*, 412 U.S. 346, 352, 361 (1973) are to the same effect.

Recently, this Court summarized that willfullness entails "a voluntary, intentional violation of a known legal duty." *United States* v. *Pompanino*, 429 U.S. 10, 12 (1976). Needless to say, one's legal duty ordinarily includes only the duty to use reasonable care to know and comply with the applicable law. Absolute liability is the rare exception not the rule.

Willful violation of the securities laws has long been regarded as "something far different from an unwitting or innocent violation." Hearings on Stock Exchange Practices Before Senate Committee on Banking & Currency, 73d Cong., 2d Sess. 6967 (1934); 2 Loss, Securities Regulation 1311 n.98. (2d Ed. 1961).

In the case at bar, petitioner was apprised by a third party that allegations of misconduct had been made against two of his firm's salesmen. He in turn informed the representatives of these same allegations. From these facts the lower court concluded that petitioner willfully aided and abetted their violation of the securities law because he failed to stop the misrepresentations. This conclusion ignores the important fact that petitioner's knowledge went only to allegations of misconduct not to specific violations of the law and certainly not to what further acts he was required to undertake to establish past violations, if any, or to prevent future violations.

For the future, willful violation might be found in similar circumstances based upon careless disregard for the inter-

pretative guidance of the Commission thereby necessitating an enforcement proceeding for injunctive relief. But the petitioner did not have the benefit of any such guidance at the time he acted. He had the benefit only of allegations of misconduct. He did not fail to act. He did discuss the allegations with the accused. There was no showing that he had reason to act further on the basis of allegations of misconduct merely because there was a potential for further abuse. The Commission's position suggests, without stating, the outrageous proposition that petitioner should have fired the salesmen on the basis of mere allegation under penalty of being an absolute guarantor of their future conduct.

> "A requirement that an offense be committed willfully is satisfied if a person acts knowingly with respect to the material elements of the offense, unless a purpose to impose further requirements plainly appears." Model Penal Code, § 2.02(8), Comment at 130, ¶ 10 (1962).

On the record before this Court, petitioner did not act knowingly with respect to the material elements of the offense. Injunctive relief was improper.

CONCLUSION

For the aforegoing reasons, the judgment and opinion of the United States Court of Appeals for the Second Circuit should be reversed.

Respectfully submitted,

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[1] We wish to acknowledge the assitance of Lewis Hu, a law student at DePaul University College of Law.